U.S. Department of Labor

Employment and Training Administration
200 Constitution Avenue, N.W.
Washington, D.C. 20210

APR 25 2014

Mr. Dale R. Folwell
Assistant Secretary
Division of Employment Security
North Carolina Department of Commerce
P.O. Box 25903
Raleigh, NC 27611

Dear Assistant Secretary Folwell:

I am writing to follow up on our discussion of the North Carolina Division of Employment Security (DES) practice of providing notices of unemployment compensation (UC) appeals hearings to private attorneys. During our discussion with you and others in DES, and in our letter dated March 7, 2014, we advised that this practice raises several issues of substantial compliance with Federal law requirements (identified below in "Applicable Federal laws"), and instructed DES to immediately cease the practice of providing notices of appeals hearings to attorneys who do not already represent a claimant or an employer. At the time, DES was subject to an order from the Wake County Superior Court to continue the practice of providing notices of hearing until a hearing could be held on an attorney's petition for an injunction to prevent the agency from changing the existing practice. On Thursday, March 13, 2014, the court issued a preliminary injunction ordering DES to continue to make notices of UC appeals hearings available to attorneys until the dispute goes to trial. As a result, DES remains out of substantial compliance with Federal law requirements. If this substantial compliance issue is not appropriately resolved, this could ultimately result in a discontinuation of approval for North Carolina to receive grants to administer its UC law, as provided in section 303(b) of the Social Security Act (SSA). A detailed discussion follows.

Applicable Federal laws. Confidentiality of UC information is governed by regulations at 20 CFR Part 603. These regulations are one means of implementing the "methods of administration" requirement in section 303(a), SSA. UC appeals are governed by section 303(a)(3), SSA, requiring fair hearings. Section 303(a)(8) requires that states expend their administrative grant funds "solely for the purposes and in the amounts found necessary by the Secretary of Labor for the proper and efficient administration" of state law. In addition, receipt and use of program income is governed by regulations at 29 CFR Part 97 and corresponding OMB circulars.

Methods of administration requirement – Section 303(a)(1), SSA, requires "such methods of administration…as are found by the Secretary of Labor to be reasonably calculated to insure full payment of unemployment compensation when due." As a "method of administration," 20 CFR 603.4(b) provides that a State law must include provision for "maintaining the confidentiality of any UC information which reveals the name or any identifying particular about any individual or any past or present employing unit, or which could foreseeably be combined with other publicly available information to reveal any such particulars." A State law must also include provisions for barring disclosure of confidential UC information, unless the disclosure is permitted or required as provided in the regulation. See 20 CFR 603.4(b).

Confidential UC information to be protected under section 603.4(b) includes "information in the records of a State or State UC agency that pertains to the administration of the State UC law," as well as claim information. See 20 CFR 603.2(b) and (j). Claim information is defined in section 603.2(a)(1) to include: information on whether an individual has applied for UC; the individual's address; and "other information contained in the records of the State UC agency that is needed by the requesting agency to verify eligibility for, and the amount of, benefits." A notice of appeals hearing that contains claim information must, therefore, be kept confidential.

Section 603.5(b) permits the "disclosure of appeals records *and* decisions, and precedential determinations on coverage of employers, employment, and wages...provided all social security account numbers have been removed and such disclosure is otherwise consistent with Federal and State law." (Emphasis added.) The Department of Labor (Department) interprets this provision to mean that only final decisions may be disclosed, and the records of those hearings that led to the final decisions. There can be no "appeals record" until such time as a hearing has been conducted. Finally, appeals records and decisions may be disclosed only if state law provides that these final decisions are part of the public record. In concluding that there can be no appeals record until a hearing is conducted and a decision rendered, the Department considers that first-level UC appeals hearings are neither judicial nor quasi-judicial; they are less formal. Common law or statutory rules of evidence or rules of procedure do not apply, and hearing officers are required to conduct hearings in an impartial manner, so as to determine the substantial rights of the parties.

Fair hearing requirement – Section 303(a)(3) SSA, requires that state unemployment insurance law include provision for "...opportunity for a fair hearing, before an impartial tribunal, for all individuals whose claims for unemployment compensation are denied...." The Department has long interpreted 303(a)(1) and 303(a)(3), SSA, to require appeal and hearing procedures to be simple, speedy, and inexpensive. Unemployment Insurance Program Letter No. 26-90 provides that "a claimant should be able to understand the appeals procedures without the need of securing legal representation to protect his or her rights...it would place a financial burden on most claimants if a State's appeals hearings became so complex that claimants would have to secure legal representation to protect their rights to benefits." Employment and Training (ET) Handbook No. 382, discussed in more detail below, explains the hearing officer's responsibility to conduct appeals hearings in such a way that both the claimant and the employer, regardless of representation, receive a fair hearing. Relatedly, neither a claimant nor an employer should have to anticipate a need to absorb the financial burden of retaining counsel; an attorney initiating contact with a claimant or employer with the state UC agency's apparent consent could cause either to anticipate such a need. The North Carolina Bar's own rules at Rule 7.3 address solicitation of clients, and Comment 1 provides—

> There is potential for abuse inherent in direct in-person, live telephone or real-time electronic contact by a lawyer with a prospective client known to need legal services. These forms of contact between a lawyer and a prospective client subject the layperson to the private importuning of the trained advocate in a direct interpersonal encounter. The prospective client, who may already feel overwhelmed by the circumstances giving rise to the need for legal service, may find it difficult to fully evaluate all available alternatives with reasoned judgment and appropriate self-interest in the fact of the lawyer's presence and insistence upon being retained immediately. The situation is fraught with the possibility of undue influence, intimidation, and over-reaching.

There has been no argument that North Carolina's hearing officers are not meeting their responsibilities to conduct hearings in such a way as to afford both sides of the dispute a fair hearing. Thus, the Department must conclude that, by providing information to attorneys that permits those attorneys to contact the parties to an appeal to solicit representation, the state is creating an environment whereby appeals hearings may not be simple, speedy, and inexpensive, and where the parties may feel pressured or compelled to retain an attorney when none is needed.

Proper use of grant funds for administration of UC program – Section 303(a)(8), SSA, provides that all money received by a state as administration grants under Title III, SSA, must be expended "solely for the purposes and in the amounts found necessary by the Secretary of Labor for the proper and efficient administration of" state UC law. In addition, under section 303(a)(9), SSA, states must return any UC administrative grant funds that "because of any action or contingency, have been lost or have been expended for purposes other than, or in amounts in excess of, those found necessary by the Secretary of Labor for the proper administration" of state law.

Section 603.8 of 20 CFR provides that administrative grant funds may be used to pay the costs of only those disclosures of UC information necessary for the proper administration of the UC program. Section 603.8(c) of 20 CFR provides that "[t]he costs to a State or State UC agency of processing and handling a request for disclosure of information must be calculated in accordance with the cost principles and administrative requirements of 29 CFR part 97 and Office of Management and Budget [OMB] Circular No. A-87 (Revised)."

Program income – The Department provides funding for the administration of the state's UC program and in many states, the UC program receives no funding from the state's general revenues. As noted above, section 303(a)(8), SSA, requires that states expend their administrative grant funds "solely for the purposes and in the amounts necessary by the Secretary of Labor for the proper and efficient administration" of state UC law. The regulations in 29 CFR part 97, corresponding to OMB Circular No. A-102, govern the administration of grants by the Department. OMB Circular No. A-87, codified in regulations in 2 CFR part 225, establishes standards for determining costs that states may charge to grants, contracts, and other Federal financial awards, and provide that profits are "unallowable" when charged to grant funds themselves. However, they neither address nor prohibit profits when those profits are not paid out of grant funds.

OMB Circular No. A-102 clarifies OMB's position – stated in OMB Circular No. A-87 – that a fee or profit to the grantee or subgrantee is not an allowable cost that may be charged against the grant. However, Circular No. A-102 also permits, indeed encourages, grantees to generate income to defray program costs when such income is not paid out of grant funds. Section 97.25(b) of 29 CFR defines "program income" as "gross income received by the grantee or subgrantee directly generated by grant supported activity, or earned solely as a result of the grant agreement during the grant period." In short, program income is generated by grant-related activity. Additionally, under section 97.25(a), "[p]rogram income includes income from fees for services performed, from the use or rental of real or personal property acquired with grant funds, from the sale of commodities or items fabricated under a grant agreement, and from payments of principal and interest on loans made with grant funds."

Section 303(b), SSA, provides that if a state fails to comply substantially with any of the requirements specified in subsection (a), "the Secretary of Labor shall notify such State agency that further payments will not be made to the State until the Secretary of Labor is satisfied that there is no longer any such…failure to comply."

Substantial compliance issues. As explained above, the fact that an individual has filed a claim, and any identifying information about any past or present employer, is confidential. Thus, disclosing that an individual or an employer is a party to an informal, first-level appeals hearing, and disclosing the statutory basis for the denial or granting of benefits, is inconsistent with the confidentiality provisions of Federal law. We reiterate that UI appeals hearings are neither judicial nor quasi-judicial; rather, they are informal. Neither common law nor statutory rules of evidence, nor rules of procedure, apply. Hearing officers, unlike judges in judicial or quasi-judicial administrative proceedings, are required to participate in questioning parties and witnesses, if necessary, so as to determine the substantive rights of the parties and ensure a complete record.

In addition, the practice of providing notices of appeals hearings to attorneys who do not already represent a party to the appeal raises an issue with the fair hearing requirement discussed above. While claimants have the right to representation at the hearings, DES has an obligation to provide hearings that are simple, speedy, and inexpensive to parties without the need for representation. The fact that claimants and employers are, with DES consent, being contacted by attorneys prior to their hearings could suggest to parties that DES believes legal representation is needed for UC appeals. This may unduly influence claimants and employers to believe that they must have legal representation to adequately participate in the appeals process, which undermines the requirement that appeals hearings must be simple, speedy, and inexpensive. These hearings should not be overly technical or complex, and should be accessible and understandable to claimants and employers who do not have representation. Claimants should be provided the opportunity to know and protect their rights without finding it necessary to hire an attorney to do so. Furthermore, state appeals hearing officers are required to conduct hearings in such a way as to protect the substantive rights of the parties. When parties are unrepresented, hearing officers are required to assist those parties in presenting their cases. Rather than merely adjudicating the facts presented by the claimant and the employer, the hearing officer has an affirmative obligation to obtain, by asking questions, reasonably available competent evidence necessary to support a decision. ET Handbook No. 382 requires hearing officers to explain procedures and ask single-point questions using clear and understandable language, avoiding unnecessary legal phrases and technical jargon. A claimant or employer might be unaware of this and, due to being contacted by an attorney with DES' apparent consent, instead believe that absorbing the expense of an attorney is critical to protecting one's rights. That the state bar rules acknowledge this risk underscores that the risk is real of a claimant or employer retaining an attorney unnecessarily.

The practice of providing hearing notices raises another substantial compliance issue, relating to the proper use of administrative grant funds and program income. As previously noted, 29 CFR part 97 permits income to be received as the result of a financial agreement between a state UC agency as grantee and a third-party private entity, and is consistent with regulations at sections 603.8(c) and (e) of the confidentiality regulation. Profits (or income above the cost of the service provided) from such an agreement would be defined as "program income" and would be subject to the use limitations established by 29 CFR 97.25(g). In summary, because the disclosure of information about appeals hearings to private attorneys is not necessary for the proper administration of the UC program, grant funds may not be used to pay any of the costs of making such disclosures. Moreover, any income received as costs for making these disclosures must be treated as program income and reported as such. Such program income may not, however, be used to offset the costs of providing the notices since those costs are not allowable under the grant.

Consequences for failure to comply substantially with Federal law. As noted above, North Carolina must be in substantial compliance with the provisions of section 303, SSA, to obtain administrative grants under Title III, SSA. A finding that the state is not in substantial compliance could result in the loss of these administrative grants. Moreover, the withholding of Title III, SSA, administrative grants may result in the state being ineligible to administer the agreements for the Federal programs of Unemployment Compensation for Ex-Servicemembers (UCX), Unemployment Compensation for Federal Employees (UCFE), Trade Adjustment Assistance (TAA), and Disaster Unemployment Assistance (DUA). We note, too, that for North Carolina employers to be entitled to full credit against their contributions under the Federal Unemployment Tax Act, the State must continue to operate a UC program consistent with Federal law, even if it is no longer receiving a UC administrative grant funds.

Corrective actions. To be in substantial compliance with Federal law, DES must cease the practice of providing notices of appeals hearings to attorneys who do not already represent a claimant or an employer, and provide assurances that the practice has stopped and will not be resumed. Any administrative grant funds that were used for the purpose of disclosing confidential UC information to third parties must be returned to the Federal Government, and any program income from the sale of appeals notices must be properly accounted for. The State also must request that recipients of confidential UC information both dispose of the information by returning the information to DES or destroying it, as would be required of recipients of lawful disclosure under section 603.9(b)(1)(vi), and immediately stop soliciting business using any confidential UC information already provided. In addition, we strongly recommend that DES consider notifying the claimants and employers whose personal information was disclosed.

Resolution. DES has an affirmative duty to explore all avenues to come into compliance with Federal law, including through the court system with the current proceedings, but also potentially via legislative remedy as discussed below. DES must respond to this letter within 30 days of mailing with an explanation of how the agency intends to resolve these noncompliance issues, and must provide an update on the status of the court proceedings. If the temporary restraining order issued by the court is appealable, or if the court issues a permanent injunction, DES must vigorously pursue an appeal.

We note that North Carolina law at G.S. 96-4(x) is consistent with the requirements and prohibitions in 20 CFR part 603, and provides penalties for unauthorized disclosure or improper use of confidential UC information. However, as we understand it, North Carolina's public records provisions, in particular G.S. 132-6, form the basis of the current action filed against the agency. To keep your law in conformity with Federal UC law and to prevent future improper disclosures of confidential UC information, we strongly suggest that DES pursue an amendment to North Carolina law to exempt UC information from public records disclosures.

We urge all state government officials to work cooperatively to resolve this matter as expeditiously as possible. Please do not hesitate to contact me at (202) 693-3029 or gilbert.gay@dol.gov should you have questions regarding this letter.

Sincerely,

Gay M. Gilbert
Administrator
Office of Unemployment Insurance

cc: Les Range
Regional Administrator
Atlanta